Brussels, 6 September 2019

EACB Answer

to ESMA's call for evidence on the 'Impact of the inducements and costs and charges disclosures requirements under MiFID II'

September 2019

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%.

For further details, please visit www.eacb.coop

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Introduction

The EACB welcomes the opportunity to participate in ESMA's call for evidence under mandate of Article 90(1)(h) of MiFID II, which obliges the European Commission (with the assistance of ESMA) to review the impact of inducements disclosures requirements on the provision of **investment advice** or **any ancillary services** to the client (in accordance with Article 24(9) of MIFID II).

Our co-operative bank members (as credit institutions within scope of MiFID II) traditionally provide investment advice and ancillary services as defined under MIFID II to retail clients (but also to professional clients and eligible counterparties), placing us in a suitable position to discuss impacts on clients and business with respect to the above.

We are also pleased to see that the Commission has included in its MiFID II/ MiFIR review the costs and charges disclosures requirements under Article 24(4) of MiFID II, which have also had an impact on the provision of investment services and performance of investment activities of our members. However, we regret that stakeholders have been given a very short period over the summer break to provide feedback on the disclosure of the above-mentioned topics. We therefore strongly encourage ESMA to confirm any decisions made out of this call through a subsequent public consultation that should run over a three month period.

In the meantime, please find below the EACB's replies to the questions from section 4 of ESMA's call-for-evidence in relation to Article 24(4) and Article 24(9).

Responses to Questions on 'Disclosure requirements for inducements permitted under Article 24(9) of MiFID II'

A What are the issues (if any) that you are encountering when applying the MiFID II disclosure requirements in relation to inducements? What would you change and why?

The inducement regime under Article 24(9) of MiFID II prohibits free research for investment firms providing portfolio management and/or independent investment advice. Credit institutions are also in scope through the sale of, and investment advice on, structured deposits. This means that in terms of disclosures, the research and execution fees must be priced separately. Indeed, the unbundling of the research is considered an inducement to trade at the detriment of end-investors' best interest.

The EACB supports the fact that the inducement regime has been introduced as a means to prevent conflicts of interest, and the increased competition observed in research provision is also positive in theory. However, we would like to draw ESMA's attention to the largest unintended consequences of this regime in practice.

Firstly, our members have noted that research unbundling has decreased the research available for investors. This is particularly true for research that covers SMEs, which are significantly financed by co-operative banks (one third of market share in Europe), and thus exposing our members and their clients to the negative repercussions, on a greater level than banks that service large corporates. This in turn goes against the objectives of the Capital Markets Union (CMU) that seek to facilitate access to finance for SMEs.

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

As execution fees are being forced down, research coverage requires sufficient liquidity (i.e. demand for research) in order to be a profitable activity. Consequently, this has reduced the incentive to provide research coverage for less liquid instruments, and decreased liquidity for high yield bonds and small-/mid-cap equities. Research providers have also diverted their business towards large caps. This impacts the financing (both debt and equity financing) and efficiency of the economy, due to the increased information asymmetry in the market (highly favourable to large hedge fund managers and banks).

Besides the uneven playing field impacting SMES, there is also a distinction made between research and corporate access that has led to substantial administrative costs without contributing to investor protection. Currently, two invoices are sent out to clients: one for research costs and the other for corporate access. This has increased the cost of invoicing to a significantly higher level than the fees charged, which is confusing investors who are now less reluctant to attend road-shows or accept bilateral meetings with corporates. This is also not conducive to achieving the CMU objective of affiliating and incentivising access to capital markets.

It is clear that the inducement regime had positive intentions both for investors (consumer protection) and their service providers (positive increased competition), but the success of these goals is questionable. Therefore, the EACB has considered the following proposals to address these consequences:

- Research and corporate access should not be distinguished as this confuses clients and leads to bureaucracy;
- Clear guidance on the scope of inducement rules on corporate access should be given. In particular, the distinction between exclusive and non-exclusive roadshows and investor conference on the one hand and research on the other hand is unclear;
- The MiFID II review should result in an explicit legal basis under which research can be received for free under the condition that there are no inducement issues, i.e. a specific exemption for trading functions where there is no direct link to underlying clients. Indeed, explicit exemption from inducement rules should be granted on research used for proprietary trading or other non-client related activities;
- There is a need for precision of free market information which regulators have deemed to be a minor non-monetary benefit;
- Equal treatment and interpretation within the local market is required, including more scrutiny on buy-side adherence; and
- There is a need for a level playing field between US and EU as regards the provision of research.

In practice, monetary inducements are disclosed within the costs and charges disclosures. And in the meantime, customers have become used to the praxis of inducements being disclosed within the costs and charges disclosures.

B Do you use the ex-ante and ex-post costs and charges disclosures as a way to also comply with the inducements disclosure requirements? At which level do you disclose inducements: instrument-by-instrument, investment service or another level (please specify how)?

Yes, the ex-ante and ex-post costs and charges disclosures also include third party payments (inducements).

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

So far as concerns the level of disclosure, the requirements provide some flexibility. In our opinion such discretion should not be limited, because it allows investment firms to provide information that is suitable for their clients and consistent with further information material provided by the same investment firm.

C Have you amended your products offer as a result of the new MiFID II disclosure rules on inducements? Please explain.

Some of our members have indicated an amendment in their products offer, not only because of the MiFID II cost disclosure rules but due to the Directive in general (particularly because of the new target market regulation). Insofar as a change in their products offer as a result of the MiFID II disclosure rules on inducements, this has led to a smaller range of products which are being offered with advice (compared to the time of MiFID I), especially to retail investors. Indeed, most products are now being offered without giving advice.

The effect in these member states is that some retail investors have less products to invest in and therefore have less possibilities to have similar profits from the capital markets as professional clients. This also results in less profit to retail investors, going against the goals of the CMU.

Other members did not notice any impact of the MiFID II disclosure requirements in their product offer.

D Has the disclosure regime on inducements had any role/impact in your decision to provide independent investment advice or not?

This depends on the Member State.

For example, our members in Austria and Finland report that providing investment services on an independent basis was not the market standard before MiFID II came into force, and neither has it become the market standard post-MiFID II.

Our members in Germany reported that independent investment advice was introduced by the national legislator before MiFID II came into force. The disclosure requirements on inducements did not play a significant role for investment firms with regards to the question whether to offer independent investment advice. However, independent investment advice is offered only on a very limited extent in the German market. The vast majority of clients in Germany do not accept independent advice, for which a fee has to be paid for.

E How do you apply ex-ante and ex-post disclosures obligations under Article 24 (9) of MiFID II in case of investment services provided on a cross-border basis? Do you encounter any specific difficulty to comply with these requirements in a cross-border context? Please explain.

EACB members do not have an important enough offer of MiFID investment services on a cross border basis in order to allow to report such differences.

F If you have experience of the inducement disclosure requirements across several jurisdictions, (e.g. a firm operating in different jurisdictions), do you see a difference in how the disclosure requirements under Article 24(9) of MiFID II and

Article 11(5) of the MiFID II Delegated Directive are applied in different jurisdictions?

Please refer to our answer to Question E.

G Would you suggest changes to the disclosure regime on inducements so that investors or potential investors, especially retail ones, are better informed about possible conflicts between their interests and those of their investment service provider due to the MiFID II disclosure requirements in relation to inducements?

No, investors are already very well informed. They are provided general and detailed information on inducements on different occasions before the investment services are provided. In addition, third party payments are included in the information on costs and charges.

H What impact do you consider that the MiFID II disclosure requirements in relation to inducements have had on how investors choose their service provider and/or the investment or ancillary services they use (for instance, between independent investment advice and non-independent investment advice)?

For some of our members (e.g. Germany), the MiFID II disclosure requirements on inducements have had no influence on how investors chose their service provider and/or the investment or ancillary services they use. With regards to clients not willing to pay fees for independent advice, the offer of this kind of investment advice is limited. Indeed, in Germany the inducements based investment advice helps to offer investment services to all kinds of clients, especially retail clients with smaller income.

For other members such as in the Nordics, the number of research providers used has declined sharply by about one third. In addition, from the buy side there has been a decrease in meetings and discussions with analysts as everything has to be paid for separately under the inducements rules. This trend has been most relevant regarding credit analysts.

Responses to Questions on 'Costs and charges disclosure requirements under Article 24(4) of MiFID II

I What are the issues that you are encountering when applying the MiFID II costs disclosure requirements to professional clients and eligible counterparties, if any? Please explain why. Please describe and explain any one-off or ongoing costs or benefits.

EACB members have commented that their clients regularly complain about the overflow of information relating to the costs and charges disclosures under MiFID II, which extends such disclosure requirements to wholesale clients even in the context of banks in interbank trading to an overbearing degree. Considering that these requirements primarily serve to protect investors and are to avoid an information imbalance in transactions with professional clients and eligible counterparties, the extremely extensive information requirements cause unnecessary bureaucracy and should be cut back. Therefore, when entering transactions with eligible counterparties and/or professional clients, investment

firms should not be obliged to provide ex-ante or ex-post cost information. This also goes for the other information requirements according to the first sentence of Article 24(1).

We are aware that a solution is provided in Article 50(1) of the Commission Delegated Regulation (EU) 2017/565, which allows for limited application of the cost transparency requirements in the case of professional clients and eligible counterparties. However, this solution is not practical. Moreover, it is not possible on the basis of the applicable opt-out provision to agree on a complete waiver of the cost information, particularly in the case of investment advice, portfolio management and embedded derivatives.

Therefore as a transitional solution (and until the regulation is updated), it should be made clear by ESMA that for eligible counterparties and professional clients the ex-ante cost information can be provided also by means of standardised cost information for all products (not limited to the scope of ESMA Q&A about MiFID II/MiFIR – Investor Protection, Chapter 9, Question 23, as of 28 March 2019).

J What would you change to the cost disclosure requirements applicable to professional clients and eligible counterparties? For instance, would you allow more flexibility to disapply certain of the costs and charges requirements to such categories of clients? Would you give investment firms' clients the option to switch off the cost disclosure requirements completely or apply a different regime? Would you distinguish between per se professional clients and those treated as professional clients under Section II of Annex II of MiFID II? Would you rather align the costs and charges disclosure regime for professional clients and eligible counterparties to the one for retails? Please give detailed answers.

Further to the explanations provided to Question I above, we would propose that investment firms should not be obliged to provide ex-ante or ex-post cost information when entering into transactions with eligible counterparties and/or professional clients. This also goes for the other information requirements according to the first sentence of Art. 24(1).

We reiterate that as a transitional solution (and until the regulation is updated), it should be made clear by ESMA that for eligible counterparties and professional clients the ex-ante cost information can be provided also by means of standardised cost information for all products (not limited to the scope of ESMA Q&A about MiFID II/MiFIR – Investor Protection, chapter 9, question 23, as of 28 March 2019).

In our opinion no distinction between elected and per se professional clients is needed. As stated in Art. 54 (3) and Art. 56 (1) of the Delegated Regulation (EU) 2017/565 the European legislator assumes that these clients have the necessary level of experience and knowledge. Conversely, this means that elected as well as per se professional clients do not need any further information. As mentioned above we are of the opinion that transactions with professional clients should be exempted from the cost transparency requirements. This would also be consistent with the PRIIPS Regulation that does require the PRIIPS KID for retail clients only.

We oppose to an alignment of the costs and charges disclosure regime for professional clients and eligible counterparties to the one for retails. This would make the issue much more difficult with respect to transactions with eligible counterparties and professional clients (see our comments on "I" and "J" above).

K Do you rely on PRIIPS KIDs and/or UCITS KIIDs for your MiFID II costs disclosures? If not, why? Do you see more possible synergies between the MiFID II regime and the PRIIPS KID and UCITS KIID regimes? Please provide any qualitative and/or quantitative information you may have.

Prior to elaborating on the reliance on the UCITS KIID and PRIIPS KID, we wish to advise that for some of our members the split of 'ongoing charges' explained by ESMA in their Q&A (Question 13, page 84, last updated 6 June 2017) is misleading for investors. This is because if the investor wants to compare the information in the KIID or KID with the MiFID II cost information, they will not intuitively understand that the line "Third party payments received by the investment firm" must be added to the line "Financial instruments" in order to recoup with the ongoing charges.

Furthermore, please find below specific issues related to reliance on the KIID and/or the KID. Not all our members (e.g. Germany) rely on the KIID and/or KID for MiFID II costs and charges disclosures.

UCITS KIID

For some members, reliance is mainly placed on the UCITS KIID in the context of institutional clients. This is an issue since the UCITS KIID does not meet the requirements on costs and charges in Article 50 of the Commission Delegated Regulation. Therefore clients are being given two documents in order to disclose additional information that is not shown in the actual UCITS KIID. The ESMA Q&As (ESMA35-43-349) provide guidance indicating that the PRIIPs KID fulfils the ex-ante costs obligations required by MiFID II (except for inducements and distribution costs), and even where there is uncertainty, data exchange templates (EMT) have been developed by the markets to facilitate compliance. However, similar assurance from the ESAs in terms of compliance of the UCITS KIID with the stated MiFID II obligations is not available. Asset managers are also reluctant to distribute cost information via the EMT due to risks of misleading information from the flawed methodology, and in any case they provide this information on a voluntary basis (they are not required by law to do so).

The above issues have been prolonged due to the extension of the exemption under the PRIIPs Regulation to keep providing UCITS KIIDs until December 2021.

Therefore, we stress that clarification on UCITS KIID compliance with the MiFID II cost disclosure requirements is established either through an RTS or Q&As/Guidelines. Alternatively, a requirement for UCITS manufacturers could be introduced to require them to report the product costs (especially costs of transactions within the investment fund) in accordance with the MiFID II requirements that apply to all investment firms.

PRIIPS KID

The cost disclosure requirements under MIFID II require investment firms to provide ex-ante cost information to the client before an order is placed. This may cause difficulties particularly in telephone business and in the case of orders being received by letter, fax or remittance slip, making such mandatory disclosure not always in the best interest of the client.

The provisions regarding the PRIIPS KID (Article 13(3) PRIIPs Regulation) allow for an exemption to provide cost information after the transaction in certain cases. We advocate for a similar legal provision to be added to MiFID II for ex-ante cost transparency, in order to address this regulatory gap.

In general, we also call for alignment between the PRIIPS KID and MiFID II to ensure the presentation of the same information to clients. We would like to stress that such alignment should consider a change in the present PRIIPS methodology for transaction costs. The current methodology includes the market impact of orders which contradicts the MiFID II provision stating that "underlying market risks" should not be considered as a cost.

Another possible solution to the problem of reconciling the PRIIPS Regulation and the Delegated Regulation with MiFID II would be to dispense with the presentation of costs in the KID if the product in question was a financial instrument within the meaning of MiFID II. This would avoid giving clients contradictory information while nevertheless informing them about the costs in accordance with the requirements of MiFID II.

L If you have experience of the MiFID II costs disclosure requirements across several jurisdictions, (e.g. a firm operating in different jurisdictions), do you see a difference in how the costs disclosure requirements are applied in different jurisdictions? In such case, do you see such differences as an obstacle to comparability between products and firms? Please explain your reasons.

EACB members do not have an important enough offer of MiFID investment services on a cross border basis to allow to report such differences.

M Do you think that MiFID II should provide more detailed rules governing the timing, format and presentation of the ex-ante and ex-post disclosures (including the illustration showing the cumulative impact of costs on return)? Please explain why. What would you change?

No, as we believe that the rules are already detailed enough. However, there is the need for clarification in some aspects of timing as can be referred to in our answer to Question P.

P Do you think that the application of the MiFID II rules governing the timing of the ex-ante costs disclosure requirements should be further clarified in relation to telephone trading? What would you change?

Some of our members report that in most cases for retail clients, the investment firms report to their clients on the basis of the actual investment amount (prior to the effected transaction) and relating to the respective financial instrument. This ISIN-based cost information requirement is difficult to implement, particularly in telephone business and would result in the obligation to draw up ex-ante cost information separately for each individual financial instrument and to make this information available to the customer, both before the order. However, clients often call for immediate order execution without bureaucracy (especially in the case of highly volatile products such as equities or in the case of sell orders in a falling market). The communication of ISIN-based cost information is often not possible in telephone business before the immediate order acceptance desired by the customer. Rather, customers would first have to wait for a postal delivery before

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

the investment firm may accept an order. Another major problem in the retail sector is that many clients do not have an electronic mailbox.

Therefore, we propose that an exemption should be incorporated in respect to distance communication such as telephone business. In contrast to the provisions regarding PRIIPS KID (Art. 13 (3) PRIIPS Regulation) and the suitability statement (Art. 26 (6) MiFID II), an express legal exemption is missing which allows to provide the information afterwards in certain cases. A similar provision should be added also for ex-ante cost transparency.

With respect to transactions with eligible counterparties and professional clinets we would propose that investment firms should not be obliged to provide ex-ante or ex-post cost information at all (see "I" above).

R Are there any other aspects of the MiFID II costs disclosure requirements that you believe would need to be amended or further clarified? How? Please explain why.

We would like to conclude by saying that the EACB supports the Level 1 legal text of MiFID II/MiFIR because it is the basis for disclosure requirements that provide end-clients with clear, correct and comparable information on all costs and charges relating to the provision of investment services and financial instruments. However, we feel that in some respects the current legal concept of the information requirements is overshooting the mark (see our comments above and below insofar).

Our opinion is that any changes should be made bearing in mind that considerable IT infrastructure, administrative, legal and other costs have just recently been incurred by firms in scope for the implementation of MiFID II. It is therefore crucial that a review of the costs and charges disclosures requirements is done carefully and without haste, with the timing of any changes to Level 1, 2 and 3 texts being aligned so as to ensure an efficient implementation and transposition phase. Implementation costs can run quite high if changes in the law are introduced in a piece-meal manner. Based on the above rationale, we strongly call for 'refit' review of the current law, rather than a complete overhaul to the extent of a MiFID III/ MiFIR II situation.

The issue of cost disclosure is highly technical and cost intensive, and also requires a long and costly transposition period. So it is very problematic if new legal interpretations are continuously published. Therefore, we call for transition periods also for interpretations of any changes to these rules.

Should the European Commission launch a study on the use by retail investors of the information provided to them (consumer testing) as is currently being done for the PRIIPS Regulation, such exercise should include changes that are meaningful to investors. Any changes should take into account the type of financial instrument as well as the type of client (professional and non-professional).

On a final note, we would like to provide two other proposals for amendments/ clarifications required in the MiFID II costs disclosures requirements:

- **Harmonise the definition of cost:** We also strongly advocate for a coherent definition of "cost" in MiFID II which does not contradict or overlap other EU securities markets legislation such as PRIIPs; and

- **Opt-out for retail clients under specific conditions:** Furthermore, retail clients should also have the possibility to opt out under specific conditions. In certain cases the mandatory provision of ex-ante cost information is not always in the client's interest, especially when they are already well-informed about the costs. In a study of the German Ruhr University Bochum, almost two-thirds of the clients (62.7 percent) have expressed the wish to be able to waive ex-ante cost information. A statutory rule regarding this should be incorporated.

Contact:

The EACB trusts that its comments will be taken into account.

For further information or questions on this paper, please contact:

- Ms Marieke van Berkel, Head of Department (Marieke.vanBerkel@eacb.coop)
- Ms Tamara Chetcuti, Adviser, Financial markets (Tamara.Chetcuti@eacb.coop)